Dr Aurora Ribes Ribes*

Discriminatory Inheritance Taxation of Non-Residents in Spain: Possible Solutions

This article outlines the discriminatory inheritance tax treatment of non-residents in Spain in comparison to residents in comparable circumstances. The author questions the compatibility of the Spanish legislation applicable to non-resident taxpayers with EU law and proposes a solution that would involve granting a "right of option" for residents of other Member States and the use of inheritance tax treaties in regard to residents of non-Member States.

1. Spanish Inheritance Tax: Connecting Factors, Scope of Devolution and Applicable Law

The aim of this paper is to describe the difference in treatment in matters of inheritance tax of non-residents in Spain in comparison to residents in comparable circumstances.[1] Based on the relevant Spanish legislation currently in force and bearing in mind recent case law of the European Court of Justice (ECJ), the author questions the compatibility of the Spanish legislation applicable to non-resident taxpayers with EU law. In addition, the author proposes a solution that would involve granting a "right of option" for residents of other Member States or the use of tax treaties in regard to residents of non-Member States.

Gift and inheritance tax (GIT) is, in general, regulated by Act 29/1987 of 18 December 1987 (GITA) and Royal Decree 1929/1991 of 8 November 1991, which enacts the Gift and Inheritance Tax Regulation (GITR). Under Sec. 5 of the GITA beneficiaries of both *mortis causa* acquisitions and life insurance policies are considered taxpayers (natural persons). This section clarifies that the essential factor in such circumstances is whether or not the taxpayer is resident in Spain since this determines whether tax is levied under the immovable property or the individual income tax regime. Moreover, in regard to individual income taxation of Spanish residents, the taxpayer's residence determines the Autonomous Community (AC) in which the individual will be taxed. This may imply differences in treatment between residents in the different ACs since each AC, in accordance with the GIT legislative powers devolved to them under Act 22/2009 of 18 December 2009, regulating the financing of common regime Autonomous Communities and cities with a statute of autonomy and modifying certain tax laws (Act 22/2009), may provide different deductions and allowances.

Under Sec. 6 of the GITA, individual income tax liability applies to the total increase in net worth of residents obtained *mortis causa*, irrespective of the situs of the property or the type of assets making up the gratuitous acquisition. Natural persons who are not resident in Spain, however, are obligated to pay tax on immovable property located in Spain, shares in Spanish companies and any rights that may be exercised in Spain, as well as on sums received from life insurance policies provided by Spanish insurance companies or foreign companies that operate in Spain (Sec. 7 GITA).

With regard to territorial scope, under Sec. 2 of the GITA, GIT is levied throughout Spain, subject to the Economic Agreements in force in the Basque Country and Navarre and the provisions of international treaties that form part of domestic law. Two comments should be made in this respect.

First, as mentioned above, under Sec. 48(1) of Act 22/2009, an AC may assume legislative powers over:

> a) Reductions to the tax base. The AC may stipulate the reductions they see fit, in the case of both *inter vivos* and *mortis causa* transfers, provided they are based on social or economic circumstances specific to the AC in question. Likewise, the AC may regulate the reductions provided by national law, maintaining them in analogous conditions or increasing their amount or the percentage reduction, applying them to a greater number of persons or simplifying the requisites for their application. When the ACs create their own reductions, these shall be applied after those provided in the national legislation. If an AC decides to increase the national reduction, this greater reduction shall replace the national reduction in this particular AC. Hence, when the AC regulate the reductions applicable, they should specify whether the reduction in question has been created by them or is a national reduction which has been increased.
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> b) Tax rate.
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> c) Amounts and coefficients of pre-existing wealth.
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> d) Deductions and allowances applied to the tax liability. The deductions and allowances established by the AC must always be compatible with those provided in the national legislation governing the tax and no modifications may be made to the latter. These regional deductions and allowances shall be applied after those governed by the national legislation. (author's translation)

* **Tax Law Professor, University of Alicante (Spain). The author can be contacted at Aurora.Ribes@ua.es.** **This paper elaborates on "Taxpayers' rights and guarantees in Community and international taxation", a research project (DER2008-03473) financed by the Science and Innovation Ministry, the main researcher in respect of which is Dr. Martínez Giner.**

1. See the author's crticisim of such discrimination in earlier papers: A. Ribes Ribes, "La tributación sucesoria de los no residentes en España a la luz de la doctrina del Tribunal de Justicia de las Comunidades Europeas", presented at the XXVIII Congress of Spanish Tax Consultants Association (AEDAF) held in Valencia (Spain), 5-7 November 2009 and published in *Revista Técnica Tributaria* 88 (2010), pp. 93-117; "La necesidad de reformar el Impuesto sobre Sucesiones y Donaciones ante el Dictamen motivado de la Comisión Europea a España sobre los no residentes", *Crónica Tributaria: Boletín de actualidad* 4 (2010), pp. 27-31; and, "La desigual tributación sucesoria de los no residentes en España", *Civitas Revista Española de Derecho Financiero* 148 (2010).

In this respect, it should also be mentioned that 100% of the revenue from this tax is ceded to the ACs under Sec. 32(1) of Act 22/2009. In addition, the State has delegated the administration and collection of the tax to the ACs under Sec. 48(2) of Act 22/2009.

Secondly, it should be mentioned that although Spain has signed three inheritance tax treaties (with Greece (1919), France (1963) and Sweden (1963)), they were entered into prior to the 1982 OECD Model Convention on Estates and Inheritances (1982 OECD Model) and even before the 1966 Draft Convention for the Avoidance of Double Taxation with Respect to Taxes on Estates and Inheritances) and are now obsolete and, in practice, no longer apply. Thus, any situations of international double taxation are mitigated through the application of the unilateral measure provided in Sec. 23 of the GITA.

Given the lack of international inheritance tax treaties it is evident that legislation is required at the EU level. While it is true that the Member States have direct taxation powers, the ECJ has made the exercise of such powers conditional upon not contravening the non-discrimination principle and the fundamental freedoms of the Treaty on the Functioning of the European Union (TFEU), as will be analysed in detail in section 2 of the article.

The above raises the question, in regard to a taxable event that involves various elements in different countries (for example, a German, resident in Holland, who inherits property in Spain from a Spanish relative), of when the event is considered to have taken place in Spain. In contrast to the legislation of other Member States, which looks to where the assets are located, the Spanish legislation envisages two connecting factors:

– For cross-border purposes (Sec. 6 GITA): the taxpayer's residence in Spain (the habitual residence being determined pursuant to the Personal Income Tax Act - PITA);
– For domestic purposes (Sec. 32(5) Act 22/2009): the territory where the deceased had his habitual residence at the time of his death. The habitual residence is determined to be in a particular AC applying the rules provided for in the PITA. Nevertheless, the anti-avoidance rule in Sec. 28(1)(i)(b) Act 22/2009 should also be taken into account. Under this rule, in some cases the connecting factor to an AC is the territory in which the deceased had his habitual residence for five full years before his death. Finally, when it is not possible to determine which legislation is applicable using this connecting factor, the national legislation is applied.

As explained above, the legislation of the ACs is never applicable in regard to non-residents. This results in serious discrimination when non-residents are in a comparable situation to that of residents, for example, when the same tax rate is applicable to both and all or most of the assets are in Spain. In fact, in some cases, non-residents and residents may be said to be in an identical situation, with the result that the difference in tax treatment is discriminatory.

2. ECJ Case Law on Inheritance Issues: Application to Spanish Tax Law

In recent years, several ECJ cases have addressed the application of inheritance tax in Member States as a result of referrals for preliminary rulings by Member States regarding the compatibility of the respective national legislation with EU law, in particular, the freedoms of the TFEU.

Hence, this article briefly refers to these recent ECJ decisions, which shed light on the meaning to be given to Arts. 49 (freedom of establishment) and 63 (free movement of capital) of the TFEU (previously, Arts. 43 and 56 of the EC Treaty) and, in a sense, broaden the interpretation of Art. 18 of the TFEU by prohibiting any type of discrimination, not only discrimination based on nationality but also based on residence. In a nutshell, as a consequence of these decisions, the ECJ has reinforced the principle of neutrality in tax matters and prohibited any domestic rules that restrict these freedoms resulting in discrimination against non-residents who are in analogous situations to that of residents of the Member State in question. It should be noted that, in respect of comparable situations, the ECJ does not usually accept justifications for this lack of neutrality in domestic legislation and is very strict in interpreting such justifications.

In the *Barbier* case,[2] the controversy was over various immovable assets that the deceased (resident in Belgium) acquired in the Netherlands and whether or not it was possible to deduct, in the Netherlands, the cost of transferring legal title in regard to such assets for the purpose of calculating the tax liability to be subsequently paid by the heirs of the non-resident. According to the Netherlands tax authorities, in regard to an inheritance of a non-resident, the obligation to transfer legal title to an immovable asset located therein does not form part of the domestic debts and, therefore, cannot be deducted from the tax base for the applicable tax. However, if the deceased had resided in the Netherlands, this obligation would have been deductible, since, in this circumstance, inheritance tax is levied on all the assets and liabilities making up the inheritance.

The ECJ emphasized that such a domestic rule, pursuant to which, as a result of denying a deduction for the cost of the title transfer, the value of an immovable asset is determined for the purpose of calculating the tax liability corresponding to the inheritance, may effectively dissuade residents of other countries from buying immovable assets located in that Member State. In addition, it may result in a decrease in the value of the inheritance of a resident of a Member State other than that in which the assets are located and who is in an identical

2. ECJ, Advocate General Mischo's Opinion, 12 December 2002, Case C-364/01, *The heirs of H. Barbier v. Inspecteur van de Belastingdienst Particulieren/Ondernemingen buitenland te Heerlen*.

situation to that of Mr. Barbier. In other words, the Court concluded that the domestic rule in question restricted the free movement of capital.

This raises the questions of the effect this pronouncement would have on the situation in Spain, whether or not the Spanish inheritance tax legislation is comparable to the Dutch rule that was declared incompatible with the provisions of the TFEU and whether it should thus be amended to comply with the interpretation of the ECJ. The answer is no to all three questions since under the relevant rules, Secs. 9 and 18 of the GITA, there are no differences based on the deceased's place of residence. Specifically, Sec. 9 of the GITA provides that the tax base for *mortis causa* transfers is the net value of each heir's inheritance. This is considered to be the actual value of the assets and rights less any deductible expenses. In other words, the relevant Spanish legislation currently in force does not treat deceased persons who were resident in Spain differently from those who were non-resident. Furthermore, it is unlikely that such a distinction will be made in the near future, considering that, in this respect, legislative powers have not been devolved to the ACs.

In the *Van Hilten-van der Heijden* case,[3] concerning inheritance tax collected by the Netherlands on the deceased's estate, the question was whether or not Art. 63 of the TFEU should be interpreted in the sense that it prohibits legislation of a Member State pursuant to which the estate of a national of this Member State who died less than ten years after moving his residence from this Member State to another is liable to taxation as though the deceased had continued residing in the Member State in question, subject to a right to deduct the inheritance tax collected by the other Member State.

The ECJ emphasized that the national legislation analysed does not restrict the free movement of capital in that since the same tax regime applies to nationals who have moved their domicile abroad and those who have remained in the Member State in question, this legislation does not dissuade the former from investing in this Member State from another, or the latter from investing in another Member State from the Member State concerned. In addition, irrespective of where the assets involved are located, the value of the estate of a national who has moved his domicile abroad is not diminished. Since this legislation is only applicable to nationals of the Member State in question, it does not restrict the free movement of capital of nationals of other Member States.

With regard to the difference in treatment under the Dutch rule applicable to residents who are Dutch nationals in comparison to those who are nationals of other Member States, the ECJ considered that since no EU harmonization measures exist, such differences arise from the powers attributed to the Member States to establish, either through treaties or unilaterally, the criteria for sharing their taxing powers. Therefore, such differences cannot be considered to be discrimination prohibited under Art. 63 of the TFEU. In fact, the domestic rule that was at issue coincides with the Commentary to the 1982 OECD Model, which provides that this type of clause is aimed at preventing tax evasion by a national of one Member State who, in anticipation of his death, moves his domicile to another Member State where the inheritance tax system is more favourable.

In the *Jäger* case,[4] the compatibility of the German inheritance tax legislation, applicable to an inheritance consisting of assets in Germany and forestry and agricultural property in France, with Arts. 63 and 65 of the TFEU was questioned in regard to the following points:

- The property in France was valued at its market value whereas in regard to an identical property in Germany, a special valuation procedure is applied that values the property on average at 10% of the market value;
- Tax exoneration is available for forestry and agricultural property located in the national territory and, moreover, its residual value is considered to be only 60% of the initial value.

This domestic regulation, which undoubtedly restricts the free movement of capital, would, however, be allowed if it were applied to a situation that was not comparable or if there was a valid justification for this restriction. The ECJ examined both possibilities and found that the situations were comparable considering that under the legislation in question the calculation of inheritance tax is directly related to the value of the assets included in the inheritance. In addition, the Court held that there was no valid justification.

This leads to the consideration of the situation in Spain in matters of inheritance both in general and, in particular, regarding tax benefits for forestry and agriculture exploitations that the ACs in Spain may provide. In this respect, situations in which the tax base is reduced when the assets are located outside an AC but in Spain are not important from an EU point of view since it is a question of domestic law. However, circumstances where the ACs establish differences in tax treatment based on the location of the assets and some taxpayers cannot take advantage of such reductions because their assets or exploitations are based in other Member States would be relevant.

In practice, it is well known that in exercising their legislative powers the ACs have, in general, increased the reductions to the tax base or have adopted new reductions that, since they affect business activities or real estate, are conditional on such property or activities being in the respective AC. Hence, the following examples relating to *mortis causa* acquisitions can be mentioned:

- Tax benefits relating to a transfer of the habitual dwelling. Catalonia, Andalusia, Asturias, Cantabria,

3. ECJ, Advocate General Léger's opinion, 30 June 2005, Case C-513/03, *Heirs of M.E.A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen*.
4. ECJ, 17 January 2008, Case C-256/06, *Theodor Jäger v. Finanzamt Kusel-Landstuhl*.

La Rioja, Canary Islands, Extremadura, Balearic Islands and Madrid have increased the general reduction, whereas Canary Islands and Extremadura have also incorporated new reductions with additional requisites;

- Tax benefits relating to the transfer of a family business. Most ACs have established their own reductions, higher than the national reductions, subject to the requirement that the AC be located in the territory of the AC that provides for the reduction. In this respect, Galicia, Andalusia, Asturias, La Rioja, Murcia, Valencian Community, Canary Islands, Extremadura and Castile and León have legislated their own reductions, whereas Catalonia, Cantabria, Aragón, Balearic Islands and Madrid have increased the general reduction envisaged in the national legislation; and
- Tax benefits relating to the transfer of rural, forestry or agricultural exploitations.[5] Galicia, Catalonia, La Rioja, Valencian Community and Castile and León have created their own reductions.

The difference in treatment under the regional legislation, characterized by a more favourable tax rate for businesses or exploitations located in the AC than for those located in other Member States, implies, in the author's opinion a restriction on the free movement of capital totally lacking in justification.[6] Therefore, the autonomous legislators should pay particular attention to the provisions of EU law on this matter and introduce the appropriate amendments; otherwise such autonomous legislation runs the risk of being declared contrary to Art. 63 of the TFEU as interpreted by the ECJ.

Furthermore, with regard to the *Arens-Sikken* case,[7] the ECJ held that national legislation that provides that, for the purpose of GIT, over-endowment debts resulting from a testamentary partition may not be deducted from the tax base if the deceased resided at the time of his death in a Member State other than that in which the real estate was located was incompatible with the free movement of capital. If the deceased had resided in the Netherlands, this reduction would have been applicable.

It appears evident that, although there is no decrease in the value of the estate of a resident in a Member State other than that in which the assets involved are located, as the taxable value of the immovable property remains the same whether or not the deductions are allowed, the fact remains that when calculating the tax, a distinction is made based on whether or not the deceased resided in the Netherlands. Thus, bearing in mind the progressive nature of the tax brackets, this legislation may result in higher taxation of the estate of a non-resident.

Having said this, whether or not the Dutch legislation in this respect is similar to the Spanish legislation should be analysed, in which case Spain's legislation should be amended in accordance with the ECJ decisions. However, the author has found no difference in treatment whatsoever based on the deceased's place of residence in the rules dealing with deductible debts (Sec. 13 GITA), or in those concerning partition and over-endowment (Sec. 27 GITA). Therefore, it may be concluded that the Spanish legislation is in accordance with EU law. In addition, it should be mentioned that legislative powers over these aspects have not been devolved to the ACs, thus minimizing the possibility of any amendments to the legislation in this field and guaranteeing greater stability and adaptation of the Spanish legislation currently in force to the provisions of the TFEU.

Following its previous rulings on the matter, in the *Eckelkamp* case,[8] the ECJ held that legislation of a Member State that provided that, in regard to inheritance, mortgage charges may be deducted from the value of the real estate if the deceased resided in its territory but not otherwise was contrary to the free movement of capital.

Focusing on Spain, as mentioned above, the current regulation on the deduction of debts in respect of *mortis causa* transfers contained in Sec. 13 of the GITA sets out various prerequisites for debts to be deductible, but in no case is this possibility limited by the deceased's residence. There is no conflict, therefore, with the principles and freedoms of EU law. Moreover, it is unlikely that, in the near future, the free movement of capital will be contravened in this respect since the legislative powers over inheritance and gift tax devolved to the ACs do not cover the deductibility of debts regime for the purpose of determining the net value of assets.

The differences in inheritance tax criteria used by Member States resulted in the dispute settled by the ECJ in the *Block* case.[9] This case is of indubitable interest in clarifying the issue. The ECJ held that a domestic rule that did not allow the inheritance tax paid by an heir in the state in which the assets were located to be credited against the inheritance tax paid in the state of residence of the deceased, in circumstances where the assets were capital claims, was not contrary to EU law (Arts. 63 and 65 of the TFEU).

The ECJ pointed out that the TFEU does not guarantee that there will be no tax consequences when an EU citizen moves his residence to another Member State, especially bearing in mind the diversity of legislation that exists amongst the Member States, as a result of which such a move may be more or less advantageous for the

5. Likewise, Galicia, La Rioja and the Valencian Community have also provided for reductions in the tax on *inter vivos* transfers of family businesses or rural, forestry or agricultural exploitations.
6. As does López Díaz, the author considers that financial autonomy, despite the arguments of social function, tax coherence or the practical difficulties in applying identical regimes, frequently used internally to justify the differences in taxation amongst the ACs, cannot be accepted from an EU point of view as a justification for restrictions on free movement. See A. López Díaz, "La amenaza del Derecho comunitario para ciertas deducciones autonómicas en el Impuesto sobre sucesiones y donaciones", *Quincena Fiscal* 9 (2009), p. 74.
7. ECJ, 11 September 2008, Case C-43/07, *D.M.M.A. Arens-Sikken v. State Secretary of Finance.*
8. ECJ, 11 September 2008, Case C-11/07, *Hans Eckelkamp, Natalie Eckelkamp, Monica Eckelkamp, Saskia Eckelkamp, Thomas Eckelkamp, Jessica Eckelkamp, Joris Eckelkamp v. Belgische Staat.*
9. ECJ, 12 February 2009, Case C-67/08, *Margarete Block v. Finanzamt Kaufbeuren.*

citizen in question. Therefore, although the risk of double taxation may dissuade residents in Germany from investing in certain Member States due to the higher taxation they would be subject to therein than if they invested in a financial institution in Germany, it is also true that such a disadvantage derives from the legitimate parallel exercise of the taxing powers of the two Member States concerned, resulting in double taxation that can only be eliminated pursuant to a tax treaty and/or an EU harmonization measure.

Going one step further, in the *Geurts and Vogten* case[10] the ECJ held that an inheritance tax rule that requires that family businesses employ a certain number of workers within the Member State in question in order to take advantage of an exemption was incompatible with Art. 49 of the TFEU.

Applying this decision to the inheritance tax situation in Spain, it is apparent that, in principle, the relevant tax legislation is in agreement with the ECJ's interpretation of Art. 49 of the TFEU, in that the reductions to the tax base contained in Sec. 20(2)(c) of the GITA for the transfer of a family business are applicable to both resident and non-resident taxpayers under Sec. 20(4) of the GITA. Therefore, there are no requirements regarding workers or their effective place of employment that would result in a tax benefit being obtained only in certain cases.[11] Hence, in this respect, Spain's inheritance legislation is in accordance with the decisions of the ECJ, although it should be noted that the reduction for the transfer of family businesses may be regulated by the AC in which the deceased resided prior to his death. Therefore, in exercising their legislative powers, the ACs should not introduce any rules that lead to discrimination and, as in the case analysed, infringement of the freedom of establishment of EU citizens.

3. Discriminatory Treatment of Non-Residents in Spain in Matters of Inheritance: Possible Breaches of EU Law

Having explained the premises upon which the Spanish inheritance tax system is based, the author questions its compliance with the free movement of capital enshrined in Arts. 63 and 65 of the TFEU, as recently interpreted by the ECJ. In particular, non-residents in a similar situation to that of residents but, as a result of the devolution of legislative powers to the ACs and the exercise of these powers, which establish substantial tax benefits for residents in their territory, are deprived of these regional reductions and allowances – even in circumstances where they have the same ability to pay as resident heirs - simply because they are not resident in Spain.

Indeed, the growing use by ACs of their legislative powers, especially in important areas, such as reductions to the tax base, tax rates, tax liability and allowances, makes it essential to correctly determine both the competent tax authority and the applicable law in order to apply the tax, based on the connecting factors provided for in Sec. 32 of Act 22/2009. These connecting criteria, however, in regard to common regime ACs, do not apply to taxpayers that are taxed on the basis that the assets are in Spain, rather than on the basis of residency, since, in this event, the state has jurisdiction and national laws are applicable. It should be added that, in addition to having jurisdiction when the taxpayer is a non-resident, the national tax authorities also have jurisdiction in regard to *mortis causa* transfers and associated insurance policies when the deceased is a non-resident in Spain, except in respect of the Basque Country and Navarre.

Although there may be discrimination concerning reductions to the tax base, as mentioned in 2., under Sec. 20(4) of the GITA such reductions are applicable to non-residents and only restrict the free movement of capital if the state or ACs introduce additional prerequisites, as may be seen in some regional rules that, in regard to a transfer of a sole proprietorship or professional enterprise, make the reduction conditional on the domicile of the entity remaining in the AC in question for a certain period of time (10 years in Asturias and Castile and León; five years in Andalusia, Galicia and La Rioja).[12] The possible discrimination that may arise as a result of applying the reductions for kinship groups to the tax base of residents, but not to that of non-residents in a similar situation – since the national legislation is applicable to the latter – should also be borne in mind.

The AC reductions for kinship (group II), family businesses and exploitations, in force in 2010, are summarized below:

Tax Base: reductions for kinship (group II)

- National legislation: EUR 15,956.87;
- Additional reductions: Madrid (EUR 16,000), Catalonia (see table 1), Canary Islands (EUR 18,500), Balearic Islands (EUR 25,000), Valencian Community (EUR 40,000) and Castile and León (EUR 60,000);
- Total reduction (100% or net tax base = 0) provided that:
  - in regard to Aragón, the taxpayer's tax base is less than EUR 150,000 and the taxpayer's pre-existing wealth is less than EUR 402,678.11); and
  - in regard to Andalusia, the taxpayer's tax base is less than EUR 175,000 and the taxpayer's pre-existing wealth is less than EUR 402,678.11).

10. ECJ, 25 October 2007, Case C-464/05, *Maria Geurts and Dennis Vogten v. The Belgian State.*

11. Ruiz Almendral, nevertheless, wonders "if, using similar arguments to those used in *Geurts and Vogten*, the simple fact that a certain participation of family members is required in order to take advantage of the exemption, as occurs in the case of wealth tax and gift and inheritance tax, may not be contrary to Community law. Although *relative* does not imply *resident*, it is more likely for the family members of a resident in Spain to also be Spanish (and resident), and so this could be considered disguised discrimination." See V. Ruiz Almendral, "Entre la discriminación y la armonización: el régimen fiscal del no residente en España a la luz del Derecho comunitario", *Revista de contabilidad y tributación* 307 (2008), p. 55.

12. In Ruiz Almendral's opinion, "this most likely means that moving the domicile to another member state of the EU would result in the levy of a true exit tax, which would hardly be compatible with Community law". See Ruiz Almendral, note 17, p. 55.

Tax Base: reductions for family businesses

- National legislation: 95% (no territorial prerequisite;
- ACs that have a territorial prerequisite:
  - 99%: Andalusia, Asturias, Canary Islands, Castile and León, Galicia, Murcia and La Rioja; and
  - 98% in Aragón and 100% in Extremadura; and
- ACs that have no territorial prerequisite:
  - 95%: Balearic Islands, Catalonia, Madrid and Valencian Community; and
  - 98% in Cantabria.

Tax Base: reductions for exploitations

- Territorial criteria:
  - Balearic Islands: 95% (assets in protected rural areas or those of agricultural interest);
  - Castile and León: 99% (agricultural exploitations);
  - Catalonia: 95% (rural property dedicated to agriculture or forestry);
  - Galicia: 99% (agricultural exploitations); and
  - La Rioja: 99% (agricultural exploitations).

The problem is exacerbated in regard to tax deductions and allowances currently established by most ACs. Since these are regional measures, they are not applicable to non-residents, even when they are in a similar situation to that of residents. Obviously, the degree of discrimination and, consequently, contravention of EU law varies depending on the size of the reductions regulated by the various ACs. For example, there is (1) minor discrimination between residents and non-residents when the deceased's last residence was in Catalonia or Extremadura; and (2) flagrant discrimination of relatives in groups I and II, when the deceased resided in the Balearic Islands, the Canary Islands, Castile - La Mancha, Castile and León, Madrid, Murcia, La Rioja and the Valencian Community. In other ACs the tax treatment varies as shown in the following table:[13]

Table 1: Autonomous Communities' tax benefits applicable to tax liability

Community	Situation	Technical specifications	Comments
Andalusia	No tax benefits applicable to the tax liability.		
Aragón	No tax benefits applicable to the tax liability.		
Asturias	100% allowance for acquisitions by relatives in group II.		Tax base < EUR 150,000 and pre-existing wealth< EUR 402,678.11.
Balearic Islands	99% allowance for acquisitions by relatives in groups I and II (formula).	Allowance applied to tax liability.	
Canary Islands	99.9% allowance for acquisitions by relatives in groups I and II.	Allowance applied to tax liability.	
Cantabria	Allowance for acquisitions by relatives in groups I and II: 99% (tax base < EUR 175,000), 95% (tax base < EUR 250,000) or 90% (tax base < EUR 325,000).	Allowance applied to tax liability.	This allowance is applicable as of 1 January 2010 (Cantabria Fiscal Measures and Finance Act 6/2009 of 28 December 2009).
Castile-La Mancha	95% allowance for acquisitions by relatives in groups I and II.	Allowance applied to tax liability.	
Castile and León	99% allowance for acquisitions by relatives in groups I and II.	Allowance applied to the tax liability.	
Catalonia	No tax benefits applicable to the tax liability.		
Extremadura	No tax benefits applicable to the tax liability.		
Galicia	Tax-free acquisitions for relatives in group I. Tax-free acquisitions for relatives in group II, provided that the tax base is equal to or less than EUR 125,000. Special rates of between 5% and 18% for acquisitions by relatives in groups I and II.	Deducted from tax liability and special rate.	
Madrid	99% allowance for acquisitions for relatives in groups I and II.	Allowance applied to the tax liability.	

13. Effective 1 September 2010.

Community	Situation	Technical specifications	Comments
Murcia	99% allowance for relatives in group 1 with no limits. 99% allowance for relatives in group II, up to a limit of EUR 450,000 of tax liability.	Allowance applied to tax liability.	
La Rioja	99% allowance for acquisitions by relatives in groups I and II.	Deducted from tax liability.	
Valencian Community	99% allowance for acquisitions by relatives in groups I and II.	Allowance applied to tax liability.	Prerequisite: the taxpayer's habitual residence must be in the Valencian Community.

In the author's opinion, the situation of residents and non-residents is only similar in the following circumstances:

1. Where there are two heirs (groups I and II) subject to the same tax rate: both descendants of the deceased, one of whom resides in Spain and the other abroad;
2. Where the deceased was resident in Spain; and
3. Where all the assets of the deceased are located in Spain.

Consider, for example, the case of two brothers, one resident in Spain and the other resident in another Member State, each of whom inherits half the estate of their father who, at the time of his death, resided in the Valencian Community. Since the national legislation is applied to the brother in the other Member State he cannot take advantage of the GIT reductions established by the ACs and is, therefore, subject to more burdensome taxation. In the author's opinion, there is no justification for the difference in treatment.

ECJ case law, which considers inheritances as a form of movement of capital, is based on an analysis of comparable, not purely domestic, situations and requires a valid justification (overriding reason in the public interest) in order to permit a restriction caused by the domestic legislation of a Member State. In light of this holding, the author believes that the higher tax burden borne by non-resident taxpayers in Spain, when they are in a comparable situation to that of residents as described in the previous example, constitutes discrimination that infringes the provisions of the TFEU.

In this respect, it is apparent that the legislation in question meets the criteria set out by the ECJ to be classified as a restriction on the free movement of capital. In the author's opinion there is no valid justification for this discriminatory treatment of non-residents. As the ECJ has repeatedly pointed out, the state of residence is empowered to provide tax benefits that, due to their subjective nature, or the fact that they are intended for families, are only applicable to residents in their territory, since it is only logical that these types of personal reductions are granted by the state where the taxpayer resides. It should be noted, however, that in the case we are considering, the situations are similar. For this reason, discriminating against non-residents (by subjecting them to higher taxation) contravenes EU law in circumstances where it is not known if they have the same ability to pay, the deceased resided in Spain and all or most of his estate is in Spain.

In this context, it comes as no surprise that the Commission sent a reasoned opinion to Spain on 5 May 2010, formally requesting that the tax system currently applicable to gifts and inheritance, pursuant to which a higher tax burden is imposed on non-residents and assets located abroad, be amended on the basis that it is incompatible with the free movement of workers and capital enshrined in Arts. 49 and 63 of the TFEU.

This opinion forms part of the infringement procedure provided for in Art. 258 of the TFEU that the Commission may initiate in cases where it detects a breach of EU law. This procedure consists of three phases: formal notice, a reasoned opinion and a referral to the ECJ. Under the current stage, Spain is obliged to adapt its domestic law to EU law within a period of two months, otherwise the Commission may bring the case before the ECJ, whose ruling is binding.

4. Solutions to Cross-Border Inheritance Tax Problems

4.1. Introductory remarks

The lack of international treaties in this area, together with a scarcity of bilateral treaties,[14] as well as the fact that the EU authorities have not taken any initiative to harmonize the law in this area, explains the differences and discrimination that exist today regarding the taxation of cross-border succession. Although the work of the Commission has, thus far, centred exclusively on the civil aspects of the matter, they included in their work programme for 2009 a Communication (which is expected to be published by the Directorate General for Taxation and Customs Union in 2010) encouraging Member States to enter into multilateral treaties, which may be a prelude to a European draft directive on succession.

14. G. Maisto, General report on "Death as a taxable event and its international ramifications", *Cahiers de droit fiscal international,* Vol. 95b (Amersfoort: Sdu Fiscale & Financiële Uitgevers, 2010), pp. 17-60.

4.2. Possible solutions at the domestic level

One possible solution at the domestic level, apart from signing additional bilateral treaties and reactivating those that already exist (with Greece, France and Switzerland), would be to create a right of option for EU residents like that provided for in Sec. 46 of the Consolidated Non-residents' Income Tax Act (CNRITA) and Sec. 20 et seq. of its Regulation, which would allow non-residents to be taxed under the individual income tax system applicable to residents. This right of option would be given to residents in other Member States who are in a similar situation to that of residents in Spain, i.e. where the deceased was resident in Spain and at least 75% of his estate is located therein. In such circumstances, as well as in others that might involve not only a comparable but an identical situation between residents and non-residents, the exercise of this right of option would allow for the same tax burden to be imposed, thus putting an end to the existing difference in treatment.

Nevertheless, Advocate General Ruiz-Jarabo questioned, in his Opinion[15] in the *Gielen* case, whether such a right of option does indeed neutralize discriminatory treatment. Far from viewing this right of option as a solution, he considers it a means of validating an illegality. This reasoning was confirmed by the ECJ in its decision of 18 March 2010, in which it expressly clarifies that discrimination cannot be justified by giving non-residents the right to opt for the tax regime applicable to resident taxpayers. On this point the ECJ referred to its decision in the *FII GLO* case,[16] in which it ruled that a national regime restricting the freedom of establishment is still incompatible with EU law if it is optional.

Given the above, the author is of the opinion that the provision of a right of option by the Spanish legislator is appropriate as an initial measure in view of the formal notice issued by the Commission. However, such a provision does not fully resolve the problem since, as the ECJ found in the *Gielen* case, a taxpayer may make a complaint in a specific situation, in which case the solution offered would prove to be insufficient and the applicable regulation would need to be substantially amended. This would imply making significant changes not only to Act 3/2009 of 18 December 2009 amending the Autonomous Communities Financing Act 8/1980 (UCFA), and Act 22/2009 of 18 December 2009 regulating the financing of common regime Autonomous Communities and cities with a Statute of Autonomy and amending certain tax rules, but also the UCFA itself in order to bring the taxation of EU residents in line with the principles enshrined in the TFEU.

4.3. Possible solutions at the international level

Given the differences between resident and non-resident taxation, which are exacerbated due to the fact that the tax is markedly fractionated, particularly in regard to relatives in groups I and II, tax treaties would offer a possible solution. This would change the focus of attention to the most problematic situation and that which gives rise to the greatest number of disputes, that is, the situation in which the three circumstances mentioned above in 3. exist: (1) where two heirs (groups I and II) are subject to the same tax rate: both descendants of the deceased, one resident in Spain and the other abroad; (2) where the deceased is resident in Spain; and, (3) where the entire estate of the deceased is located in Spain.

The obvious discrimination that exists under the domestic legislation currently in force, based on whether or not the heir resides in Spain, would be eliminated if tax treaties were entered into since, under such treaties, the place in which the assets (immovable property and certain other assets) that are transferred *mortis causa* are located would be used as the connecting factor. In practice, this would mean making the deceased's place of residence the only connecting factor in the majority of cases.

The existence of a single connecting factor, since the deceased's place of residence and the place in which his assets are located is usually the same, would transform the tax into a true inheritance tax, rather than a tax on heirs, and the place of residence of the latter would be irrelevant. In this manner, the conflict that arises when the residence of beneficiaries is used as the connecting factor would be eliminated in determining the applicable legislation. A good example of this would be the treaties between Spain and France and Sweden. Although they need to be renegotiated and adapted to the 1982 OECD Model, they use this connecting factor and help to minimize any possible conflicts in this respect. The author would, therefore, encourage the states, Spain in particular, to enter into more international inheritance tax treaties (and to revise existing tax treaties) as a valid mechanism to avoid discrimination between residents and non-residents when the two are in a comparable situation. The obvious disinterest shown by the state legislator regarding GIT, which tax is, in fact, being eliminated by the ACs, should not be a reason to underestimate this problem, since not only is the system inherently lacking in equity but it may also be in breach of EU law.

5. Conclusions

To conclude, it is anticipated that the initiative taken by the Commission in publishing the announced Communication, the doctrine laid down by the ECJ and the efforts made by Member States to adapt their legislation to this case law, will result in cross-border inheritance taxation more in line with EU principles and the fundamental freedoms.

15. ECJ, Advocate General Ruiz-Jarabo's Opinion, 27 October 2009, Case C-440/08, *F. Gielen v. Staatssecretaris van Financiën*. As he points out in the second paragraph, "this case presents the Court with an opportunity to determine whether, in the light of its case law on direct taxation, a right of option for the purpose of taxation neutralises discriminatory treatment. However, […], the placing of resident and non-resident taxpayers on an equal footing may be misleading, […]."
16. ECJ, 12 December 2006, Case C-446/04, *Test Claimants in the Franked Investment Income Group Litigation v. Commissioners of Inland Revenue*, Para. 162.